

# *BACKGROUND PAPER FOR HEARING*

## **CALIFORNIA BOARD OF ACCOUNTANCY**

### **IDENTIFIED ISSUES, QUESTIONS FOR THE BOARD, BACKGROUND CONCERNING ISSUES, AND PRELIMINARY RECOMMENDATIONS**

**PRIOR SUNSET REVIEW:** The Board of Accountancy (Board) was last reviewed by the Joint Legislative Sunset Review Committee (JLSRC) five years ago (1995-96). The JLSRC and the Department of Consumer Affairs (DCA) identified a number of issues and problem areas concerning this Board. For example, the JLSRC found that the Board: (1) had not established professional standards for its licensees; (2) exceeded its legal authority by restricting the use of the terms “accountant” and “accountancy;” (3) granted or delegated inappropriate authority to its committees; (4) had not properly evaluated the need for specified education, experience and continuing education requirements; (5) provided a national examination developed and controlled by a national trade association that had a very low pass rate and had not been properly validated; (5) spent a low percentage of its budget on enforcement activity; (6) had a higher percentage of support staff to CPA investigative staff; (7) had significant delays in its complaint and investigation process; (8) lacked an aggressive enforcement program; (9) maintained a complex, costly and multi-layered enforcement program; (10) took little action against licensees for incompetence or other violations of its licensing act; and (11) focused a large part of its enforcement program on unlicensed activity. The JLSRC also found that the composition of the Board did not provide a sufficient number of public members and that its budget was out of compliance with the statutory requirement that it only maintain a three-month reserve. The JLSRC reached the conclusion that components of the current regulatory program do not appear to provide protections to the consumer and preclude consumer harm.

Despite these findings, the JLSRC recommended continuing the Board of Accountancy, but directed the Board to implement a number of recommendations and changes. Some of these included: (1) adopt professional standards for its licensees; (2) clarify in regulations when a person other than a CPA may use the terms “accountant” and “accountancy;” (3) eliminate the administrative (enforcement) committee of the Board, but in the meantime it should act in an advisory capacity only; (4) evaluate the need for specified education, experience and continuing education requirements; (5) clarify the “attest” experience requirement for licensure; (6) work toward implementation of a national examination which could be developed and administered by a “non-trade” national organization such as the National Association of State Boards of Accountancy; (7) spend more of its budget on enforcement activities and take a more proactive role in its enforcement program; (8) increase the number of CPA investigative staff; (9) conduct a study on the “major case” (enforcement) program of the Board to determine the successes (or failures) of the program; (10) reduce delays in the complaint and investigation process; (11) make more use of its restitution authority (12) reduce licensing fees to bring its budget reserve within legal requirements; and, (13) increase the size of the Board from 12 to 13, with 7 public members and 6 professional members.

The JLSRC also reviewed whether licensing and regulation of the practice of public accounting should continue and found: (1) There is sufficient evidence that the unregulated practice of public accounting could cause significant public harm. (2) There appears to be significant public demand and an expectation by the public for the regulation and licensing of the practice of public accountancy. (3) The current regulatory program appears to provide evidence that severe harm could result if the public accountancy profession was deregulated. (4) Other mechanisms to protect the public from harm appear to be inadequate if the practice of public accountancy was deregulated. (5) While a number of other occupations overlap some of the functions performed by licensees of the board, these other occupations are not licensed to perform the full range of public accounting services which includes audits and attestation. In addition, these other occupations are not governed by the professional standards and codes of conduct that characterize licensed accounting professionals. (6) There are other public agencies that provide some oversight of the services provided by accountants, but none of these agencies has authority to license or discipline practitioners of public accounting. (7) All 54 states and jurisdictions regulate accounting professionals. (8) There does not appear to be any substantial savings to the consumer (agencies or businesses) if the practice of public accountancy was deregulated, and in fact, deregulation could adversely impact the business climate in California. (9) There does not appear to be any viable alternative to the current regulatory program that would provide the same degree or increased consumer protection.

In September, 2000 the Board of Accountancy submitted its required sunset report to the JLSRC. In this report, information of which is provided in Members' binders, the Board described actions it has taken since the Board's prior review. The Board addressed several issues presented during its last review. It also implemented some of the following changes pursuant to recommendations of the JLSRC:

- Legislation and regulations to improve the Licensure Program, especially in the areas of continuing education and firm registration.
- Legislation and regulations to improve the Enforcement Program, including the establishment of a reportable events requirement.
- Regulations related to professional conduct, including disclosure requirements for licensees accepting commissions.
- Completion of studies related to education, experience, and continuing education as mandated at the last sunset review.
- Re-engineering of the Enforcement Program.
- Use of Internet technology including on-line exam application processing.

The following are unresolved issues pertaining to this Board, or areas of concern for the JLSRC, along with background information concerning the particular issue. Where necessary, the staff of the JLSRC has made preliminary recommendations for Members and the Department of Consumer Affairs to consider. There are also questions that staff has asked concerning the particular issue. The Board was provided with these issues and questions and is prepared to address each one if necessary.

# CURRENT SUNSET REVIEW ISSUES

## **BOARD COMPOSITION ISSUES**

**ISSUE #1:** The current composition of the board is a professional majority rather than a public majority. Almost all non-health related consumer boards have a public membership majority. There also appears to be no need for a Public Accountant (PA) representative on the Board.

**Question #1 for the Board:** *Why shouldn't three additional public members be added to the Board, which would provide a public majority, but still retain the current number of professional members on the Board? Should the PA member on the Board sunset and be replaced with a CPA member?*

**Background:** This issue of Board composition was considered during the previous sunset review. At that time, the Board recommended retention of the then current 12-member Board. One reason was to ensure that there would be a sufficient number of Board members and a broad enough range of expertise to address the Board's workload and attendant issues. The JLSRC recommended a 13-member Board inclusive of seven public members. The increase in the number of Board members from 12 to 13 was recommended to address workload concerns raised by the Board. DCA and the Center for Public Interest Law (CPIL) also made recommendations related to Board composition. DCA recommended an 11-member Board with six public members. In its written comments to the JLSRC, the CPIL recommended a Board composed entirely of public members.

None of these recommendations was enacted. Instead, the change in Board composition was the result of 1994 legislation (SB 2038, Chapter 1273) which contained a provision to reduce the Board to 10 members — 6 licensee and 4 public members, commencing in July 1997. SB 2031 (Chapter 1136, Statutes of 1996) continued the Board after sunset review, but it did not modify this provision. While the 10 member Board continues to have a majority of licensee members, the change in composition did increase the ratio of public members to licensees.

Those who support a public member majority argue that licensees are reluctant to take discipline against "one of their own" and are easily influenced by representatives of the profession. They maintain that decreasing the number of licensees and increasing the number of public members would result in a more effective enforcement program, enhanced consumer protection, and policies that encourage fair competition. Conversely, those who believe a public majority is undesirable argue that consumer protection may be decreased because many public members lack the expertise and commitment to understand highly technical accounting and auditing issues in the complex cases that they consider.

Support for a public majority is based, in part, on the assumption that licensee Board members share a similar point of view that is fundamentally different from public Board members. This assumption may be validated by the voting patterns of some licensing boards. The Board argues, however, that this assumption is not supported by the votes cast at Board of Accountancy meetings. Board minutes show that licensees and public members do not constitute distinct voting blocks. Rather, voting patterns reflect the perspectives and values of the individual Board members.

The Board's Sunset Review Committee reviewed these arguments when it discussed Board composition in January 1999. In addition to these issues and workload concerns, members also noted that it would be difficult to represent a cross-section of the profession with fewer licensee members of the Board.

Also at the January 1999 meeting, the Board's Sunset Review Committee decided to recommend eliminating the requirement that there be a Public Accountant (PA) member of the Board. The rationale for this recommendation is that the number of PAs holding active licenses is declining, and it is becoming increasingly difficult to find a qualified, interested PA to serve on the Board. As of March 2000, there were fewer than 250 PAs with active licenses (compared to more than 36,000 active CPAs), and the average age of current licensed PAs is 79. The last PA license was issued in 1968, so this population will continue to decline. The Board considered this recommendation in May 1999, and it voted to recommend to the Legislature that the Board continue to be composed of 6 licensees and 4 public members, but that the statute broadly refer to "licensees" and not specifically to CPA and PA Board members.

Although the Board has continued to recommend a professional majority, Joint Committee members should give serious consideration to adding three additional public members that would provide for a public member majority but retain the current number of professional CPAs on the Board. This would be consistent with the recommendation of the JLSRC when this Board was reviewed five years ago and consistent with the primary objective of the committee to increase public representation on all boards. Currently there is only one other professional trade-type board that does not have a public majority, and that is the Architect's Board. They have 10 members, with 5 professional and 5 public members. However, this even split between the membership of this board will be of concern to the JLSRC when it is reviewed once again in the year 2002. For now, boards that have a public majority of one member include the Engineers, Contractors, Geologists, Court Reporters, Structural Pest Control, Vocational Nurses, and the Board of Behavioral Sciences. Most health-related boards have a professional majority but only by one member.

It should also be noted, that there was a study conducted in 1989, by the School of Public Administration at the University of Southern California, which found in part, after reviewing a number of state boards, that professional majority boards tend to have fewer serious disciplinary actions, and concluded that the number of professionals on the board consistently affects board performance in pursuing disciplinary actions against licensees.<sup>1</sup> The Center for Public Interest Law (CPIL) has also outlined a number of concerns with this Board, which will be reflected in this paper, and believes that such problems may not have occurred if this Board had a public majority.

**Preliminary Recommendation #1:** *Three additional public members should be added to this Board which would make it a 13-member Board with 7 public members and 6 professional (CPA) members. The PA member should sunset and be replaced with a CPA member, but only if recommendation #2 is adopted.*

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<sup>1</sup> Elizabeth Graddy and Michael B. Nicol, Public Members on Occupational Licensing Boards: Effect on Legislative Regulatory Reforms, 55 So. Econ. J. 610, 612 (1989).

**ISSUE #2:** It does not appear that the current requirements for the professional composition of the Board, with only one CPA required from a small firm, adequately reflects a cross section of the accounting profession.

**Question #2 for the Board:** *Should it be required that the Board have at least two CPAs from small firms, and one CPA who is a sole proprietor?*

**Background:** During the discussion regarding PA representation on the Board, representatives from the Society of California Accountants (SCA), which represents small firms, expressed concern that, if it eliminates the PA member position, the Board may not adequately consider the views of small accounting firms. It was noted that current Business and Professions Code Section 5000 requires that one of the CPA Board members be from a small firm. To provide for small firm representation, an SCA representative suggested the statute could require that two licensee Board members be from small firms.

Currently, at least 32% of active licensees come from small firms of two to 10 licensees. Approximately 36% are sole proprietors, 12% work in medium size firms with 11 to 50 licensees, and 16% work in large firms with 100 or more licensees.<sup>2</sup> It seems reasonable to assume that out of 6 CPA professional members, at least two should be from small firms, and consideration should be given to assuring that at least one CPA member is a sole proprietor. The Board has not made any recommendation concerning this issue.

**Preliminary Recommendation #2:** *At least two of the professional CPA members on the Board should be from a small firm, and one member should be a sole proprietor.*

## **BUDGETARY ISSUE**

**ISSUE #3:** The Board has been unable to comply with the requirement that its contingent fund reserve balance equal only three months of estimated annual authorized expenditures. The Board recommends that the reserve level be increased to at least six months. It also recommends exam-related fees be increased.

**Question #3 for the Board:** *Why does the Board believe that the reserve level should be changed from three months, to between three to six months, and that exam-related fees be increased?*

**Background:** Business and Professions Code Section 5134 mandates the Board to fix the biennial renewal fees so that the Board's reserve is approximately equal to three months of authorized

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<sup>2</sup> In October 1995, the California Board of Accountancy commenced a study to evaluate the value and effectiveness of continuing education in providing consumer protection. Over a two-year period, staff collected statistical data and demographic information were collected from renewing licensees concerning both their practices and the continuing education they were given. In addition, two opinion surveys on continuing education were completed by a representative group of licensees chosen at random from the general licensing population. Data were also collected from a wide range of archival sources, such as the Board's Report Quality Monitoring Program. Staff published its initial report in September 1998; the Board later revised staff's findings and conclusions and released its own report in September 1999. This report shall be cited as the "CE Board Report." Information regarding firm size was obtained from Page 15 of the CE Board Report.

expenditures. In its 1996 Report, the JLSRC recommended that the Board reduce its fees as necessary to bring its budget reserve into compliance with the law. Since 1995, the Board has moved to achieve compliance through four separate fee actions.

After these concerted efforts, the Board has only recently been successful in reducing the reserve close to the mandated level. One reason for the difficulty is the fluctuating amounts of revenues the Board receives. While theoretically it may be possible to fine tune revenues through frequent fee adjustments, the lengthy time frames required to revise fee regulations make this strategy impractical and burdensome to administer. More important, the Board argues, frequent fee adjustments would be unfair and confusing to licensees. Therefore, for the sake of equity and clarity, the Board believes that Section 5134 should be revised to allow a reserve level of up to six months of budgeted expenditures. This would be consistent with the JLSRC's recommendation regarding other Boards, that they attempt to keep their reserve levels within three to six months of budgeted expenditures.

Another fee issue the Board would like to bring to the attention of the JLSRC relates to fees for the Uniform Certified Public Accountant Examination. Section 5134 requires the Board to charge fees equal to the cost of purchasing and administering the examination, up to a ceiling of \$250. Currently, if a candidate takes all parts of the four-part examination, the fee is \$160.

The developer of the exam, the AICPA, plans to move from paper-based testing to computer-based testing in August 2003. While the precise cost of the computerized examination is unknown at this time, based on information provided by the AICPA, the Board believes the fee for all four parts will be increased to a range of \$440 to \$460. The Board believes it would be prudent to amend Section 5134 at this time in anticipation of the increased costs. Subsequently, the Board would adjust its fees in regulations to cover the estimated actual cost.

**Preliminary Recommendation:** *Section 5134 of the Business and Professions Code should be amended to allow the Board to maintain a budget reserve level of between three to six months of budgeted expenditures. Section 5134 should also be amended to allow for an increase in the Board's examination fee up to a ceiling of between \$440 to \$460. Prior to passage of this fee increase, however, the Board should provide more precise costs expected by AICPA.*

## **LICENSURE ISSUES**

**ISSUE #4:** It appears as if all current licensing categories regulated by the Board should be continued.

**Question #4 for the Board:** *Does the Board believe any of its current licensing categories could be eliminated sometime in the future?*

**Background:** The Board currently licenses CPAs, PAs, accountancy partnerships, and accountancy professional corporations.

In its February 1996 Report to the Department of Consumer Affairs, the JLSRC recommended that the state continue the licensure and regulation of the practice of public accountancy. The primary reason for this recommendation was that the unregulated practice of public accounting would result in severe consumer harm and therefore could adversely impact California's business climate.

The practice of public accounting is very broad. Individuals, large and small businesses, governmental agencies, and nonprofit organizations all rely on licensees for attest and accounting services, tax preparation, financial planning, and business consultation. These direct consumers of public accounting services can be harmed by incompetent or unethical practice.

In addition, billions of dollars are invested annually in numerous publicly traded companies by both individual and institutional investors such as retirement systems and pension plans. Financial statements audited by licensees are an important source of information for these third party consumers. Incompetent or unethical practice in this area can contribute to significant, broad public harm. Conversely, the availability of licensee services for a wide variety of business transactions benefits consumers and allows California businesses to compete effectively in the global marketplace. Continued regulation by the state is essential to provide for consumer protection related to these vital services. There does not appear, at this time, any reason why these licensing categories should not be retained.

**Preliminary Recommendation #4:** *Current licensing categories regulated by the Board should be retained.*

**ISSUE #5:** Section 2 of Title 16 of the Board's regulation has been argued in the past as too broad and overly vague in defining appropriate titles and designations that may only be used by licensed CPAs and PAs.

**Question #5 for the Board:** *Why does the Board believe that it is not necessary to revise Section 2?*

**Background:** The Board, pursuant Business and Professions Code Section 5058, adopted Section 2 of Title 16 of the California Code of Regulation. Section 5058 deals with the use of confusing titles by those who are not licensed by the Board, and if used, may lead someone to believe they are dealing with a licensed CPA or PA. It states in part that "*No person or partnership shall assume or use the title designation "chartered accountant," "certified accountant," "enrolled accountant," "registered accountant" or "licensed accountant," or any other title or designation likely to be confused with "certified public accountant" or "public accountant."*

The Board adopted Section 2 of Title 16, to clarify what other titles or designations are likely to be confused with Certified Public Accountant or Public Accountant.

*"The following are titles or designations likely to be confused with the titles Certified Public Accountant and Public Accountant within the meaning of Section 5058 of the Business and Professions Code:*

*(a) "Accountant," "auditor," "accounting," "auditing," when used either singly or collectively or in conjunction with other titles.*

*(b) Any other titles or designations which imply that the individual is engaged in the practice of public accountancy".*

The Board's enforcement of this regulation was discussed in the JLSRC's 1996 Report. The report indicated that the Board's rationale for enforcing this regulation was that when the terms "accountant" or "accountancy" are used by non-licensees, consumers are confused and incorrectly believe that the

person is licensed by the state. The Board indicated the preventing the use of these terms was supported by an April 1987, California Poll conducted by Field Research Corporation that showed that 55 percent of those surveyed believed that a person who advertises as an “accountant” is state licensed.

Differing points of view on this issue resulted in litigation. Plaintiffs (including non-CPA accountants and their professional associations) argued that the CPA-controlled board is attempting to capture the use of a generic term to prevent the competition from truthfully and effectively advertising in telephone directories and other media, in violation of non-CPAs’ first amendment commercial speech rights and due process rights. The issue was litigated for five years, culminating in the California Supreme Court’s decision in *Bonnie Moore v. State Board of Accountancy*, 2 Cal. 4th 999 (1992), *cert. denied*, \_\_\_U.S.\_\_\_ (Feb. 22, 1993). The Court ruled that the Board must allow non-CPA accountants to use the terms “accountant” and “accountancy” in their advertising if those terms are accompanied with a disclaimer stating that “the practitioner is not licensed, or that the services offered do not require a license.”

The Center for Public Interest Law (CPIL) argued that, because the Supreme Court found Rule 2 to be constitutionally defective, the board should either repeal or amend this regulation. The board argued, that the legal case validated the regulatory scheme enforced by the board prohibiting the unmodified use of the terms “accountant” or “accounting” by unlicensed persons [unless a disclaimer is used], and received legal advice from the Attorney General’s Office in October 1994, that it did not have to revise Rule 2.

However, the JLSRC recommended, that for the legal authority of the board to be clear under these circumstances, it is probably advisable that the board amend Rule 2 to include the disclaimer provision (and statement) of the court.

The Board has taken no action pursuant to this regulation, and still argues, that based on the Attorney General’s Office opinion of 1994, it “continues to be guided by this legal advice.” It also indicated that it administers Section 2 with flexibility, keeping in mind the guidance provided by the Court. Copies of the case are provided to non-licensees as an informational document.

CPIL still argues Section 2 is still inconsistent with the Supreme Court’s ruling and should be amended. It was the clear intent of the Court that non-CPAs be allowed to use these terms as long as they include a statement/disclaimer, either that they are not licensed as a CPA/PA, or that the services being offered do not require a CPA license. If one reads this regulation literally, it still prohibits a non-accountant from using any of the terms listed. There is no mention of the disclaimer provision enunciated by the Court.

**Preliminary Recommendation #5:** *The Board should provide to the JLSRC a copy of the Attorney General Opinion of 1994. The JLSRC will seek a Legislative Counsel opinion concerning any conflicts between Section 5058 of the Business and Professions Code and Section 2 of Title 16 of the California Code of Regulations as it concerns the California Supreme Court’s decision in Bonnie Moore v. State Board of Accountancy.*



**ISSUE #6: Will the recommended change by the Board, to increase the educational requirement from 120 semester-hours to 150 semester-hours to be licensed as a CPA, act as an unnecessary barrier to entry of the CPA profession?**

**Question #6 for the Board:** *Why should the educational requirement to be licensed as a CPA be increased to 150 semester-hours? If this is to conform to the Uniform Accountancy Act (UAA), what evidence is there that California applicants currently lack the appropriate education or are having problems with performance on the CPA examination, or with reciprocity? What additional education would be required, and in what subject areas, and what would the impact of costs be on accounting students? Are all state colleges and universities able to provide these additional course and semester-hour requirements? What percentage of current licensees believe that additional education is necessary? Have future applicants (students) been surveyed concerning this new educational requirement? What impact would this requirement have on foreign graduates?*

**Background:** The Board is seeking to enact several provisions of the Uniform Accountancy Act (UAA) which it has long hoped to incorporate into California law. The Board has provided to the JLSRC proposed revisions to the California Accountancy Act to implement these recommended changes.

The UAA is a model bill and set of regulations drafted by the American Institute of Certified Public Accountants (AICPA), the major national trade association of CPAs, and the National Association of State Boards of Accountancy (NASBA), a coalition of all CPA regulatory boards in the United States.

Specifically, the Board seeks to enact UAA provisions that would significantly change California law affecting the so-called “three Es” of CPA licensure—education, experience, and examination. In a nutshell, the Board proposes to: (1) increase the amount of education necessary for CPA licensure, from 120 semester-hours generally, with or without an undergraduate degree, to 150-semester hours with an undergraduate degree – and the equivalent of a master’s degree;<sup>3</sup> (2) decrease its existing accounting experience requirement of 2 to 4 years, depending on education level, to 1 year, and eliminate the current requirement that applicants for CPA licensure have experience in the “attest” function (the preparation of a certified financial audit); (3) register those firms involved in providing “attest” services and provide for peer review of these firms; and, (4) adopt the UAA’s exam passage standards.

Prior to its first sunset review in 1995-96, the Board did attempt to implement the 150-semester hour requirement. In 1991, SB 869 (Boatwright) was introduced. This bill encountered opposition from the Administration and others who contended that the 150-semester hour requirement would be an unnecessary barrier to entry. Because of this opposition, SB 869 did not pass.

Although the 150 semester-hour requirement was not a significant issue at the last sunset review, the Board did indicate its intent to eventually adopt some of the UAA provisions. The JLSRC and DCA directed the Board to conduct a study on its education, examination and experience requirements, and the overall impact these new requirements may have on those who wish to enter the profession. The

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<sup>3</sup> Under Section 5081.1(c) of the Business and Professions Code, an applicant may qualify for a CPA license without completing the 120 hours of college-level coursework. They also are not required to obtain an undergraduate degree. A candidate can have a community college degree and then have taken up to 120 semester units. However, many candidates (at least 75% of those surveyed in a recent Board study) have a Bachelors degree and at least 66% obtained the degree in accounting.

study was mandated as part of SB 1077 (Greene) (Chapter 1137, Statutes of 1996), and the Board was to provide this report at its next sunset review along with its proposed changes to the Accountancy Act.

To satisfy that directive, the Board contracted with Dr. Oriel Strickland, a professor of industrial organizational psychology at CSU Sacramento, who conducted a study that utilized a variety of methods aimed at “thoroughly assessing the impact of potential changes to the current education and experience requirements” for CPA licensure.<sup>4</sup>

Findings of the Study Related to the Education and Experience Requirements for Licensure in California. Currently 45 of the 50 states have enacted the 150 semester-hour requirement. Approximately 37 percent of candidates of the May 1998 CPA examination had already completed the 150 semester-hours or more. However, 29 percent completed less than 130 units and could be significantly impacted if 150 semester-hours were required. Findings were also mixed regarding the benefits of the 150 semester-hour requirement. No relationship was found between the number of semester units candidates completed and their performance on any section of the Uniform CPA Examination, therefore, there was no strong evidence for this requirement to improve passage of the Examination.

Candidates for the examination indicated they anticipated some negative outcomes such as financial burden and difficulty in completing the requirement and were generally not very favorable regarding the requirement. However, a slight majority of “licensee” respondents indicated that the 150 semester-hour requirement could result in positive outcomes, such as increased respect for CPAs, entry-level competency, and better preparation for employment.

A review of some of the literature regarding this requirement from other states pointed towards negative outcomes, such as: (1) higher client fees; (2) decreased market competition; (3) no guarantee of a more qualified CPA since extra course work is not specified; (4) minorities, lower income, working and single parent students would be severely affected because of additional cost and time; (5) colleges and universities may be ill-prepared to offer five-year programs and may not be able to attract enough accounting students; (6) additional costs of this requirement will ultimately be paid by consumers. Another state’s survey also suggests that the majority of CPAs think additional education requirements are unnecessary, and since only three states have had even five years of experience with the implementation of this requirement, it is difficult to judge outcomes as expressed above.

As far as impact on California colleges and universities, it was found that the requirement might have a bigger impact on the UC system since 121 semester units is all that is currently required, and that the literature reviewed also suggests there could be a potential problem with small private California colleges if there is a decline in the number of students pursuing accountancy degrees. In a survey conducted of universities and colleges in California, it was indicated that only one third of CSU campuses provide a Masters degree in accountancy. Some however do provide an MBA with some accounting coursework requirements. No UC campuses provide a Masters degree in accountancy.

As far as whether candidates would have difficulty becoming licensed in other states that currently require the 150 semester-hour requirement, the study found that most of the licensees sampled (90%)

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<sup>4</sup> This study was titled, “A Series of Studies Related to the Education and Experience Requirements for Licensure in California” and was completed in June 1999. It shall be cited as the “Board’s Education and Experience Requirement Study.”

have not applied for licensure in other states, of the 10 percent who did apply only 22 percent of those surveyed or (38 CPAs) experienced difficulties.

The study did not focus on the impact this requirement may have on foreign students applying for a CPA license in California. It did indicate, however, that of those surveyed, about 17% were found to have a foreign equivalent of the current educational requirements.

Board Arguments in Support of the 150 Semester-Hour Requirement. As stated by the Board, if California fails to establish the 150-semester hour requirement soon, less qualified individuals may take the examination in California specifically because educational requirements are less rigorous than in other states. Another significant reason why the 150-semester hour requirement is needed is because it is an essential component in a broad-based effort to establish more uniform licensure requirements nationwide. More uniform requirements are needed to regulate effectively in an environment in which the widespread use of new technology has created a global marketplace. The UAA provides a framework for this essential uniformity.

The key components of this framework are 150 semester-hours of education, the UAA exam passage standard, and the UAA's one year general experience requirement. These components have been embraced by 40 of the 54 jurisdictions. Enactment of the 150-semester hour education requirement is an essential step if California is ever to achieve consistency with the rest of the nation.

It is the Board's view that establishment of uniformity will not only facilitate reciprocity, but also enhance the efficiency of professional regulation for the benefit of consumers. As advances in information and communication technology continue to accelerate the pace and scope of business transactions, more efficient professional regulation may be critical for consumer protection in the years to come. The Board also believes that the additional educational hours will give applicants a broader range of knowledge and result in more well-rounded CPAs.

With the above benefits in mind, the Board developed its proposal to establish the "3Es" in California. In regard to the 150 semester-hour requirement, the Board seeks to make implementation as seamless as possible for both educational institutions and for candidates. For example, the Board does not propose any specific course requirements for the additional hours. This flexible requirement will allow colleges and universities to develop the curriculum they believe is appropriate. Further, to minimize the potential impact of additional tuition costs and to facilitate the transition from college to employment, the Board's proposal would allow candidates to sit for the exam with a minimum of 120 hours and a baccalaureate degree. The additional 30 hours could be completed at a later date, as long as completion is prior to application for licensure. At the same time, the Board's proposal would enhance candidates' knowledge of accounting and auditing by increasing the number of required undergraduate hours in these subjects from 10 to 24 semester-hours.

To ensure that important educational issues were not overlooked, with the assistance from the California Society of Certified Public Accountants (CSCPA), the Board's proposal was distributed to educators at 48 four-year colleges and universities and 109 community colleges. CSCPA representatives indicate receiving positive feedback from the educators they have contacted. (It should be noted that JLSRC staff have not been provided with this response from California educators.)

The Board considered findings from Dr. Strickland's study of the Board's proposed education and experience requirements and pointed out some of the more favorable findings as stated on the previous page, but also indicated that not all study findings supported the 150-semester hour requirement.

Arguments Against the 150 Semester-Hour Requirement. The Center for Public Interest Law (CPIL) argues that the report commissioned by the Board does not support its proposal. Citing the findings already stated on the previous page, it reached the conclusion that, since there is “no relationship between the number of semester hours taken and performance on any section of the CPA examination,” no requirement that additional hours be in the subject of accounting, and no indication that overall competence of the CPA will be improved, the proposal would impose nothing more than an artificial barrier to entry into the CPA profession and that it is opposed to this requirement.

In 1999, Colorado’s sunset review staff recommended elimination of the 150 semester-hour requirement that was to take effect in the year 2002. The Colorado Legislature eliminated the requirement in its 2000 Legislative Session. The following conclusions were made by the sunset review staff:

*“The 150 credit-hour educational requirement is an overly restrictive entry barrier into the accounting profession with no demonstrable public protection function. Adoption of the 150 credit-hour requirement is likely to raise consumer costs, entrench market power in those accountants who attain the CPA designation, and restrict competition. On the other hand, keeping the educational requirement at the Bachelor's level is in line with current entry level educational trends in both the private and public sectors, and will promote the optimum utilization of personnel. A full 72% of Colorado CPA survey respondents agree by indicating that the current entry-level educational requirement is "about right.”<sup>5</sup>*

Colorado educators also provided information to the sunset review staff, and indicated that the costs for students would be significant, approximately \$25,000 to complete 30 additional hours, and they feared that fewer candidates would elect to enter the profession. They pointed out that Tennessee’s experience was instructive. The state had implemented the 150 hour requirement in 1993. In 1991 (two years prior to implementation) 1,347 first time candidates took the CPA Exam, in 1995 (two years after implementation) only 386 first time takers took the exam. They believed that Colorado would likely see a decline in the availability of CPAs, and that the effect might be particularly severe in remote areas of Colorado where candidates do not have access to 150 hour programs. It would seem that the same may hold true for California.

They additionally pointed out that, because of the restricted supply of CPAs and the additional costs incurred by new entrants, consumers will experience an increase in fees paid to CPAs, and that even more serious, is what appears to be a nation-wide shortage of CPAs.<sup>6</sup>

**Preliminary Recommendation #6:** *The educational requirement to be licensed as a CPA should not be increased from 120 semester-hours to 150 semester-hours as recommended by the Board.*

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<sup>5</sup> Page 41, “Colorado State Board of Accountancy 1999 Sunset Review,” Colorado Department of Regulatory Agencies, Office of Policy and Research.

<sup>6</sup> “Shortage of Accounting Students Raises Concern on Audit Quality,” *New York Times*, February 19, 1999.

**ISSUE #7:** During the Board’s last review, the Joint Committee expressed some concern about the overly broad experience requirement for applicants and confusing provisions regarding time frames and equivalency.

**Question #7 for the Board:** *Has the Board more clearly defined the general experience requirements for applicants?*

**Background:** Business and Professions Code section 5083 requires CPA applicants to complete a certain number of years of experience under the direct supervision of a CPA licensee, generally two years if a candidate has an undergraduate degree. Section 5083(c) expressly requires the Board to “prescribe rules establishing the character and variety of experience necessary to fulfill the experience requirements set forth in this section, including a requirement that each applicant demonstrate to the board satisfactory experience in the attest function as it relates to financial statements.” To implement this experience requirement, the Board indicates that it has adopted section 11.5, Title 16 of the California Code of Regulations.

The “character and variety” of experience necessary to fulfill this general experience requirement is not spelled out in Section 11.5. This regulation primarily deals with what satisfies the “attest” experience requirement. (Usually, a certain amount of attest related hours are required to meet this requirement, but it is only a part of the overall general experience required to fulfill the experience required by Section 5083 and Rule 11.5. The attest experience requirement is dealt with in Issue #9 and #10.)

In 1995, CPIL criticized the Board’s failure to adequately define the “general experience” requirement as mandated by Section 5083(c). CPIL indicated that Section 11.5 fails to give adequate guidance either to applicants or employers about the nature of the required accounting experience, and is so vague, that the Board’s own Qualifications Committee can’t tell what types of experience satisfy the rule. The JLSRC indicated that the experience requirement should be clarified so that candidates for licensure, employers, its staff and its Qualifications Committee can more easily interpret it.

The Board indicates that Business and Professions Code Section 5083, which establishes the Board’s experience requirement, was revised effective January 1, 1995 (SB 2079, Chapter 1278, Statutes of 1994). The revised language specifies the nature of qualifying experience and eliminates confusing provisions regarding time frames and equivalency. Section 11.5 was subsequently revised to clarify attest experience requirements, address out-of-state and dated experience, and specify the part-time equivalent of full-time employment. However, the Board did not believe it was necessary to revise Section 11.5 to address the “character and variety” of qualifying general experience because to do so would duplicate provisions in Section 5083. It also indicated, that although the previous version of Section 5083 was confusing and difficult to interpret, Qualifications Committee members and staff have experienced no difficulty applying the requirements of the 1995 revised language. In 1997, with the simplified language in place, staff assumed responsibility for the review of all qualifying experience not requiring work paper assessment (approximately 85 percent of all applications).

Section 5083 (c) clearly states that the Board shall adopt regulations establishing the “character and variety” of experience necessary to fulfill the experience requirement. There are no provisions within Section 5083 that describe the character and variety of accounting experience necessary to fulfill this requirement, so it is unclear why the Board believes revising Section 11.5, to provide this description of required experience, would “duplicate” provisions in Section 5083. Section 5083 specifies the

number of years necessary to complete the experience requirement and that experience shall be performed in accordance with applicable professional standards and can be accomplished in the employ of or under the supervision of a licensed CPA. There is nothing that speaks to the character and variety of experience necessary.

**Preliminary Recommendation #7:** *Section 5083 (c) of the Business and Professions Code should be amended to clarify the Board's regulatory responsibility in defining general experience requirements for CPA applicants.*

**ISSUE #8:** If the requirement for 150-semester hours is adopted, or the applicant has 30 or more semester hours of graduate study, should the qualifying experience requirement of two years be reduced to one year as recommended by the Board?

**Question #8 for the Board:** *Why has the Board recommended a reduction in the overall experience requirement? If the UAA general experience requirement is adopted would it be broader than the current requirement? Would the Board pass regulations to define the "quality and character" of the experience necessary?*

**Background:** As discussed in Issue #6, the Board is proposing to modify its licensure requirements for consistency with the UAA and with the licensure requirements of other states and jurisdictions.<sup>7</sup> In the area of experience, this would mean streamlining the current experience requirement and adopting a one-year general experience requirement for all applicants. The Board would still require that the qualifying experience be gained in accordance with professional standards and be supervised and verified by a licensee, as is currently required in Section 5083. The Board indicates that this proposal is consistent with the JLSRC's previous sunset review recommendation that the Board consider whether fewer years of experience would suffice to ensure competency.

On the general experience issue, the Board's study on experience and education requirements surveyed 7,500 randomly chosen licensees (about 22% of the licensee population), asking them to indicate the amount of general experience needed to ensure competency under a minimum of supervision. Over two-thirds of the licensees who responded stated that either two or three years of accounting experience is necessary to ensure competency in the areas of accounting, taxation, assurance services, and attest. These licensees also noted a marked improvement in their own skill level after they had between one and three years of experience. Licensees who indicated they have management responsibility tended to feel that two years of experience is needed to ensure competency in accounting and taxation, and three years is necessary for attest and assurance services. Finally, hiring managers tended to value actual work experience more than other pre-licensure factors when evaluating entry-level job applicants.

The study does not support any reduction in the general experience requirement. However, in deliberating the matter, the Board noted that the UAA differs from the Board's current requirements by

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<sup>7</sup> The UAA Section 5-2 (November 1999), states that the experience shall include providing any type of service or advice involving the use of accounting, attest, compilation, management advisory, financial advisory, tax or consulting skills all of which was verified by a licensee, meeting requirements prescribed by the Board by rule. This experience would be acceptable if it was gained through employment in government, industry, academia or public practice. The Board's proposal slightly modifies this experience requirement is does not allow one year of experience in academia.

providing for higher, more rigorous standards for education and examination, and a lower, less complex standard for experience. The Board concluded that adopting the UAA requirements as a package would achieve greater consistency with other states without lowering the standards or making licensure requirements more burdensome for California applicants. It is the Board's view, that achieving national consistency will not only facilitate reciprocity, but also will enhance the efficiency of professional regulation for the benefit of consumers.

An additional question related to the experience requirement is, "Even if the 150-semester hour requirement is not adopted, should there be changes in the general experience requirements such as a reduction in the number of years based on graduate study?" The Board deliberated this question at the May 18, 2000, meeting of its Sunset Review Committee and at the June 12, 2000, meeting of the full Board. It was concluded that if the 150-semester hour requirement is not adopted, the Board would support a one-year experience requirement for applicants with 30 or more semester-hours of graduate study. This position is consistent with the UAA and the Board's proposal.

**Preliminary Recommendation #8:** *Section 5083 of the Business and Professions Code should only be changed to reduce the qualifying experience requirement, from two years to one year, for those applicants who have 30 or more semester hours of graduate study.*

**ISSUE #9:** During the Board's last review, the Joint Committee indicated that the audit ("attest") experience requirement should be clarified by regulation. The Joint Committee was concerned that the Board had set arbitrary policy regarding this requirement rather than using the regulatory process, amounting to "underground rulemaking" (the enforcement of a policy or standard without adopting it through the proper rulemaking procedure).

**Question #9 for the Board:** *Has the Board clarified, adopted, or changed regulations that pertain to the audit experience necessary for purposes of licensure in this State?*

**Background:** Section 5083 of the Business and Professions Code states that each applicant must demonstrate to the Board satisfactory experience in the "attest" function as it relates to financial statements, and that the attest function includes audit and review of financial statement. As indicated earlier, Section 11.5 of Title 16 of the California Code of Regulations (CCR) outlines the Board's "attest" experience requirement for licensure. Beyond what is stated in Section 5083, "attest" or "attest services" are not clearly defined by statute or in regulations.<sup>8</sup> Section 11.5 only spells out broad guidelines in determining whether or not a candidate for licensure has met the experience requirements of Section 5083.

In the previous sunset review, concern was expressed regarding this regulation and the Board's rulemaking procedures. Specifically, the Board was accused of "underground rulemaking" (the enforcement of a policy or standard without adopting it through the proper rulemaking procedure). This issue centered around the Board's Certificate of Experience or "Form E" submitted by employers to verify an applicant's qualifying experience. Two aspects of the Form E proved controversial. One

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<sup>8</sup> The Board in its proposed revision of the California Accountancy Act provides a definition of "attest." It includes an audit, a review of a financial statement, an examination of prospective financial information, and "other services" as the board may specify by regulation. This is somewhat similar to the UAA definition, but the Board's definition does not specify which national "statements of standards" shall be adopted. The UAA leaves this to the discretion of state boards of accountancy to adopt pursuant to its rulemaking authority.

was the 500-hour guideline for qualifying audit experience. A second area of contention involved a modification of the Board's requirements to make it easier for applicants to demonstrate qualifying audit experience. The Center for Public Interest Law (CPIL) suggested that the Board may have been inappropriately regulating without following the appropriate rulemaking protocol.

With regard to the 500-hour guideline, at the previous sunset review the Board provided an historical overview demonstrating that this issue was an important topic of discussion by the Board in 1980. As part of considering the issue, in April 1980 the Board held a regulation hearing and received public comments on the matter. In July 1980, after lengthy discussion, the Board concluded not to specify a fixed number of hours for audit experience. It was believed at that time that designating a fixed number of hours in regulation could unfairly disadvantage applicants from small firms. It indicated that the reference to 500 hours functions as a guideline for applicants and employers and as an aid to licensees completing the Certificate of Experience, not a fixed requirement. Because of this guideline status, the Board was advised by legal counsel it was not necessary to specify it in regulation. Even though the Board made these arguments, the JLSRC still recommended that the 500 hour guideline either be placed in Section 5083 of the B&P Code, or in Section 11.5 of its regulations. This was not done. The JLSRC has consistently argued that any policy guidelines pertaining to licensing or enforcement should be included in regulations, and a recent court decision and opinion of the Attorney General have emphasized this point. CPIL still argues that this 500 hour guideline is still underground rulemaking and that the Board should adopt this in regulation.

A second issue relates to a 1990 policy change that modified the audit experience requirement so that applicants no longer needed to prove knowledge of a long list of audit procedures. Instead, applicants were required to demonstrate an understanding of how to plan and conduct an audit with minimum supervision.

The Board indicates that critics were correct that the Board should have immediately revised its regulations for consistency with this policy change. However, the Board explains that it was involved in a major review and revision of all of its licensing statutes and regulations and concluded that the most practical approach was to address these related issues in one legislative and rulemaking effort. Enabling legislation was enacted in 1994 (SB 2079, Chapter 1278). Subsequently, in 1995 the Board revised its licensing regulations including Section 11.5. The public hearing on this matter took place in May 1995, the same year the Board was undergoing sunset review, and revisions to Section 11.5 of Title 16 went into effect in March 1996.

**Preliminary Recommendation #9:** *The Board should revise Section 11.5 of California Code of Regulations to conform with any policy regarding the “attest” experience requirement, and to conform to any changes made to Section 5083 of the Business and Professions Code. (See Issue #10 regarding changes to the “attest” experience requirement.)*

**ISSUE #10:** During the Board's last review, the Board was proposing that the audit experience be eliminated entirely. The Joint Committee indicated that this was a very controversial issue and the Board had not properly evaluated whether this experience requirement should be eliminated. The Board is once again recommending that the audit (“attest”) experience requirement be eliminated for all CPA's, and instead that only specially qualified accounting firms licensed by the Board now be allowed to perform auditing functions. These accounting firms would be subject to peer review by the Board.



**Question #10 for the Board:** *Why is the Board recommending elimination of the audit experience requirement for licensure? Have there been any studies done to determine the extent to which CPA's no longer use the attest function and whether there is a problem in gaining the experience necessary to meet the attest experience requirement? Why should attest services only be provided by specially qualified "attest firms?" Would these attest firms be licensed or registered by the state and what standards would be used to determine licensure or registration? Would all existing CPA firms be grandfathered? What type of peer review would grandfathered and newly recognized attest firms undergo? Do any other states license/register "attest firms?" Has the Board considered as an alternative certification of those performing audit ("attest") functions?*

**Background:** The Board is proposing to eliminate the attest experience requirement for licensure and only require a one-year general experience requirement for all licensing applicants to achieve consistency with the UAA. It is also recommending to set up a new registration program for firms which provide "attest services" and a new peer review program to review the work product of each of these firms.

In the previous review, the Board only proposed eliminating the attest experience requirement for licensure. The Board acknowledged that the attest function has been the traditional hallmark of the accounting profession. However, after considerable deliberation, the Board concluded that, because of the rapid pace of technological change related to financial transactions, the attest experience requirement was no longer reflective of the current public accounting environment. Because this was a controversial recommendation, and the Board and the profession appeared split on the issue, the JLSRC directed the Board to study its experience requirement and the impact this change may have on the profession.

Findings of the Studies Related to the Education, Experience and Continuing Education Requirements for Licensure in California.<sup>9</sup> Findings from the study are mixed with regard to the attest experience. Survey data indicated that more than 70 percent of licensees believe the attest experience requirement is an assurance of entry level competency, gives valuable exposure to the concepts of objectivity and independence, provides critical skills in areas other than attest, and facilitates a common basis of applying knowledge to a situation. However, for those who have passed the Uniform CPA Examination but not satisfied the experience requirement, fifty-nine percent of these respondents indicated the requirement was either excessive or no longer necessary. They also indicated that it is burdensome to get the attest experience because there aren't enough firms doing audits. However, two-thirds of licensees who were surveyed and identified themselves as hiring managers at CPA firms said they could provide audit experience to all or most of their hires.

In a separate study of continuing education requirements, the Board collected extensive statistical information about practitioners renewing their licenses with active status during the period April 1996 through October 1997. Thirty-six percent of these licensees issued at least one financial statement report (audit, review, or compilation) during the previous two years. Conversely, when asked to identify their primary area of practice, only 13 percent of these licensees selected auditing.

The Board's Proposal to Eliminate the Attest Experience Requirement, Register Firms Providing Attest Services, and Require Peer Review. The Board indicates that information from its study suggests that "auditing/attest services" are becoming somewhat of a specialty within the broader

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<sup>9</sup>"Board's Education and Experience Requirement Study" and "Board CE Study."

context of public accounting. While the current attest experience requirement exposes the applicant to auditing, it does not make the person a competent auditor. More extensive experience and education generally are needed, and knowledge must be frequently updated to ensure currency. This suggests that consumer protection may best be served through ongoing post-licensure requirements, rather than by a one-time entry level requirement. The Board has moved in this direction by implementing continuing education requirements in accounting and auditing for licensees who plan, direct, or perform substantial portions of the work in audit, review, compilation, or attestation engagements. As a further step toward this course, the Board is now proposing that attest services only be provided by specially qualified “attest firms.”

Under the Board’s proposal, it would continue to license all accountancy partnerships and professional corporations. However, to perform audits, reviews, or attestation services, a firm would need “attest status” and, as a condition of license renewal, it would be required to register as an “attest firm” and undergo peer review in accordance with professional standards. A firm whose highest level of service involves the issuance of compilations, would not need attest status, and its work products would continue to be reviewed by the Board’s Report Quality Monitoring (RQM) Program.<sup>10</sup>

Existing firms would be grandfathered. To retain attest status, these firms would be required to undergo peer review every three years. Sole proprietor providers of attest services also would have to register as a firm. Currently, sole proprietors are not required register with the Board but are allowed to practice under the individual’s CPA or PA license. It is anticipated that sole proprietor attest firm registration would be completed in conjunction with renewal of the individual license without any additional fee.<sup>11</sup>

After this proposal is implemented, a new firm seeking attest status would be required to undergo a peer review within one year of licensure. Extensions of the one-year deadline would be granted for good cause. However, while the firm is awaiting its first peer review, it would be required to employ, at a minimum, one licensee with attest experience equivalent to the experience currently required for licensure. This individual would have primary responsibility for establishing the firm’s quality control system, a critical component for providing competent attest services.

Arguments Against Eliminating the Attest Experience Requirement, and Requiring Registration and Peer Review of CPA Firms. The Center for Public Interest Law (CPIL) is opposed or unclear about several aspects of this proposal. It has indicated that the Board’s study does not validate its own proposal to make these requested changes, and that attest firm licensure is still under discussion by the national organizations and they have not set forth any uniform standards for attest firm licensure. Also, it does not appear as if states are comprehensively implementing the attest firm licensure and peer review requirements.<sup>12</sup> CPIL also points out, that required peer review raises many issues, not the least of which is cost—both to licensees and to the Board. Peer review is expensive; while large firms that choose to become licensed as “attest firms” can easily afford it, smaller firms and sole practitioners who want to perform attest may not be able to afford it. Further, either the Board would

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<sup>10</sup> The Board’s Report Quality Monitoring (RQM) Program currently samples a small percentage of licensees to review their work products. The RQM Committee will evaluate the work product and rate it as satisfactory, acceptable, marginal or substandard. If marginal or substandard, the Board will either recommend or require continuing education.

<sup>11</sup> The Board estimates there will be about 10,000 attest firms including 5,800 sole proprietors in need of peer review.

<sup>12</sup> Information provided by the AICPA indicates that as of February 24, 2000, only 9 of the 54 jurisdictions were partially or fully compliant with the UAA’s requirements related to attest experience, and 5 jurisdictions had pending legislation. 1998 statistics provided by NASBA show that 32 jurisdictions had some kind of peer review or quality review program, and 27 jurisdictions required some form of peer review as a condition of renewal.

have to establish an in-house peer review unit to review all firms that perform attest, or it would have to “contract out” that function to an external organization—most likely a professional accounting society.

The Society of California Accountants (SCA), which represents small firms, opposes the licensing or registration of “attest firms” and mandatory peer review. It views this concept as a “two-tiered” license. They argue that the candidate passes the CPA examination, gathers a minimum of any type of experience and then may be licensed. A candidate passes the exam, obtains a certain amount of attest experience and then may be licensed as an “attest firm.” There is some question as to whether the individual becomes certified as an attest firm or whether the firm becomes certified and only the firm can do the attest function. Other questions of concern to SCA are: What is the attest function? When do you qualify as an attest firm? Are you able to go back and become an attest firm? May you do any type of attest work without being an attest firm? Can you be certified retroactively? What type of maze does this conjure up? As for the peer review requirement for attest firms, SCA argues that the current RQM Program, which is a form of peer review, does not appear to have reduced major firm audit “shortcomings,” nor reduced the number of complaints filed with the Board. With mandatory peer review, small firms would be subject to additional costs in order to do business. There is also client concerns about confidentiality of documents which would be made available for peer review. SCA perceives peer review as a restraint of trade, since a licensee must either participate or else be restricted from practicing in those areas. Also what happens if a CPA fails peer review? How will they be sanctioned?

The Board has indicated that there are several areas, as mentioned by SCA, which are still unresolved. They include confidentiality of the peer review report, how attest firms will be evaluated, and indicators that will require referral to the Board’s Enforcement Program.

**Preliminary Recommendation #10:** *The “attest” experience requirement should not be eliminated for all CPA applicants. The Board should consider special certification for those individual CPAs who will perform the audit (“attest”) function and require they meet specified qualifying experience and continuing education. Registration of “attest firms” and establishing a peer review program appear unnecessary as recommended by the Board. The Board should, however, continue with its Report Quality Monitoring Program for those performing attest/audit and compilation services, and increase the amount of CPAs they review.*

**ISSUE #11:** Are the activities and role of the “Qualifications Committee” of the Board, in recommending applicants for the CPA license, an appropriate delegation of governmental decision making to participating licensees who are not members or staff of the Board?

**Question #11 for the Board:** *What function does the Qualifications Committee now serve for the Board, and are the activities of this committee now an appropriate delegation of the Board’s (and staff) authority? Why should the “Qualifications Committee” only be eliminated if the audit (“attest”) experience requirement is also eliminated?*

**Background:** Pursuant to Section 5023, the Board established a Qualifications Committee to examine all applicants for the license of CPA and to recommend to the Board applicants who fulfill the requirements, in particular the audit experience requirement to become licensed as a CPA.

In the previous review, the Board observed, that with the removal of the audit experience requirement, the Qualifications Committee could be eliminated because a need would no longer exist to evaluate applicants' audit experience for licensure. It was the Board's view that if the attest experience requirement were retained, the QC still would be needed to assess applicants' fitness for licensure through a technical review of work products. The Board also believed that the QC was the most cost-effective means of providing the necessary technical expertise.

The JLSRC recommended sunseting the QC because the Board's use of this committee appeared to be an unlawful delegation of the Board's authority to determine who should be a licensed CPA within this State. However, legislation enacted at the conclusion of sunset review (SB 1077, Greene, Chapter 1077, 1996) retained both the QC, but clarified the advisory nature of the committee.

As discussed in Issue #10, the Board is once again recommending elimination of the audit experience requirement for licensure. With the implementation of this recommendation, the Board believes the QC will no longer be needed. Staff can continue to review an applicants' general experience.

**Preliminary Recommendation #11:** *The Qualifications Committee should be utilized to evaluate those applicants who will perform attest/audit accounting services.*

**ISSUE #12:** **The Board does not recognize international reciprocity, but it indicates that it has taken steps to enhance reciprocity for those from foreign countries.**

**Question #12 for the Board:** *What steps has the Board taken to permit qualified accounting professionals from other countries to practice in California?*

**Background:** The JLSRC's previous sunset review report observed that most licensees from other states have little difficulty obtaining a California license. An applicant licensed in another state who has completed appropriate continuing education may practice in California while the application for licensure is pending, and passage of the Uniform CPA Examination in another jurisdiction generally meets the Board's examination requirements for licensure. Licensees who have practiced public accountancy for five of the last ten years in another state or jurisdiction also are deemed to meet the Board's experience requirement.

Also, as stated during the previous sunset review, the Board does not recognize international reciprocity because requirements for licensure vary widely from country to country. In many countries, standards are substantially lower than those of California or other U.S. jurisdictions. However, the Board acknowledges the global nature of the public accounting profession and has taken steps to address issues related to international reciprocity.

For example, in 1998, the Board pursued legislation (AB 2771, Assembly Committee on Consumer Protection, Governmental Efficiency, and Economic Development, Chapter 872) to permit qualified accounting professionals from other countries to take the International Uniform Certified Public Accountant Qualification Examination for California licensure. Qualification to sit for this examination is determined by the International Qualifications Appraisal Board (IQAB) which is jointly established by the AICPA and NASBA. Boards of Accountancy have the opportunity to sponsor groups of accounting professionals for IQAB approval.

The Board also made efforts to enhance reciprocity working actively with the Office of the U.S. Trade Representative in 1998 to review and revise the World Trade Organization's "Draft Disciplines for Regulation of the Accountancy Sector." The objective was to provide for equitable treatment of accounting professionals worldwide, while maintaining high standards and preserving the authority of states to effectively regulate the practice of public accounting. The agreement was adopted by the World Trade Organization, but it has not yet gone into effect.

**Preliminary Recommendation #12:** *There appears to be no need for to change the way the Board permits qualified accounting professionals from other countries to practice in California.*

## **EXAMINATION ISSUES**

**ISSUE #13:** The American Institute of Certified Public Accountants (AICPA), a national professional membership association, has primary control and ownership of the Uniform CPA Examination. Almost all state licensing examinations are provided by independent non-trade related entities because of the perceived conflict of interest posed by a professional association controlling the examination instrument. The Board argues that state boards of accountancy must at least have equal voice with the AICPA in decision-making and policy formation relative to the control, development and administration of the examination because of this inherent conflict. The Board has taken a very active role in raising the level of debate about this issue nationwide. However, it is unclear what if any changes the AICPA is willing to make.

**Question #13 for the Board:** *Discuss the Board's very active role in dealing with this issue, and its view and recommendation(s) regarding the control, ownership, development, and administration of the Uniform CPA Examination? Has the AICPA responded to any of the recommendations made by the Regulatory Coalition of (State) Boards of Accountancy?*

**Background:** For the past several years, the Board has been examining the issue of the control and ownership of the Uniform CPA Examination, with the intent of working toward a non-trade association developing and administering the exam. The Board's 1996 *Sunset Review Report* recommended "work toward implementation of a national examination developed and administered by a national organization in the future, with the proviso that the national organization be a non-trade association such as NASBA. (The JLSRC agreed with this recommendation.) The Board's 1997-1998 *Strategic Plan* also refined this recommendation into a specific objective: "Actively advocate for a national examination developed and administered by a non-trade organization."

As indicated by the Board, the reason for advocating a change in the AICPA's ownership is because of a perceived conflict of interest posed by a professional association's controlling the examination instrument. The appearance of a conflict arises because the Board's regulatory mission is consumer protection, while the association's mission must necessarily be advocacy for and protection of members. Because the examination is an essential key to opening the gateway to becoming a public accounting practitioner, the exam's being owned and controlled by a trade association — rather than by an organization representing the regulatory perspective — furthers the perception that the exam is an artificial barrier to entry into the profession, instead of an instrument to better ensure consumer protection.

In addressing this issue, alternatives to transition the current examination control structure from the AICPA to regulatory entities have been formulated, explored, and discussed by this Board. In January 1999, a comprehensive analysis of the issues relating to the ownership and administration of the Uniform CPA Examination was considered by the Committee on Professional Conduct and the full Board. With the distribution of this analysis, the Board conveyed its concerns about the inherent conflict of interests between the trade association and regulatory entities and strongly voiced its belief that boards of accountancy must have equal voices with the AICPA in decision-making and policy formation relative to the control and administration of the examination.

During 1999 and into 2000, this analysis was discussed nationally at several meetings conducted by both the AICPA and NASBA. During all of these discussions, the California Board clearly stated, that given that protection of the consumer public is the ultimate charge of each accountancy regulator, and the Uniform CPA Examination must accurately measure entry-level competency as a standard for licensure, it is each Board's duty and purpose to assure the validity, reliability, and security of the examination. Because the examination provides competency assessment and is the first line of defense for consumer protection — while the day-to-day procedures may be delegated — the ultimate responsibility for the quality of the exam remains with the state boards entrusted to protect the public.

The California Board has been challenged by the Legislature (through sunset review) to ensure the examination's validity. To that end, it is important to note that this Board has gone on record numerous times urging the expeditious completion of a current occupational analysis, even prior to the passage of AB 1105 (Jackson, Chapter 67, Statutes of 1999). This legislation requires occupational analyses for licensure programs, including an appropriate schedule for examination validation, minimum requirements for psychometrically sound examination validation, and the setting of passing standards. Again, although the AICPA has not conducted such a study since 1991, it indicates that a new occupational analysis will be formalized in the fall of 2000.

Toward seeking an equal voice in policy and decision-making, in February 2000 California took the lead in establishing the "Regulatory Coalition of Boards of Accountancy," encouraging each jurisdiction to participate in this coalition. Specific to a proposed restructuring of the AICPA Board of Examiners and its related committees, its stated objectives are the following:

- Ensure that at a minimum the AICPA and NASBA share equal ("50/50") representation, control, and decision-making powers.
- Annually rotate the Board of Examiners' chair positions between the AICPA and NASBA.
- Ensure the regulatory boards' ability to actively participate and have equal voice in all aspects of decision-making relative to both the restructuring process and final direction, form, composition, and function of the Board of Examiners.

In exploring new approaches to the development and administration of the Uniform CPA Examination, the Board also conducted a round table discussion concerning all related issues at its meeting of March 25, 2000. Participants included Board members, the Executive Director of the AICPA Examinations Team, NASBA's President and CEO, the Chair of the NASBA Board of Directors, and the Department of Consumer Affairs psychometrician who in February 2000 — at the request of this Board — conducted an audit of the AICPA's Examination Division.

The Board's active participation in urging an equal voice in decision-making and policy formation relative to the exam has raised the level of debate about this issue nationwide, and it should be commended for its efforts.

It is unclear at this time what, if any recommendations of the Regulatory Coalition of (State) Boards of Accountancy will be adopted by AICPA.

**Preliminary Recommendation #13:** *The Board should continue with its active role in dealing with issues involving the control, ownership, development, and administration of the Uniform CPA Examination by the AICPA, and report back to the JLSRC by September 1, 2001 on recommendations of the Regulatory Coalition of (State) Boards of Accountancy that have been implemented by AICPA. The Board should also report on the costs to provide a California CPA exam if these recommendations are not adopted by the AICPA.*

**ISSUE #14:** The occupational (practice) analysis for the Uniform CPA Examination is currently considered outdated by California standards, and although a new practice analysis is expected, it is unknown when the results of this analysis will be incorporated into the examination. There have also been other recommendations made by the Office of Examination Resources of the Department of Consumer Affairs to improve the administration of this examination.

**Question #14 for the Board:** *Has an occupational analysis for the Uniform CPA Examination been completed and published and how can California assure that: (1) the results of this analysis will be immediately incorporated into this examination; (2) the current examination satisfies validity requirements until the new practice analysis is put into place; and, (3) future occupational analyses will be completed in a timely manner (at least every five years)? Has the AICPA responded to other recommendations made by the Office of Examination Resources of the Department of Consumer Affairs?*

**Background:** An occupational analysis related to this examination was completed in June 2000 and was to be published in the fall of 2000. (The JLSRC has not received a copy of this analysis to date.) During the time between the AICPA's 1991, and most recent occupational analyses, two examination content specifications update studies were performed by the Professional Examination Service, Department of Research and Development. The first study, completed in March 1999, related to the information technology knowledge required by CPAs in public accounting. The second study, completed in May 2000, related to the general business knowledge required by CPAs in public accounting.

In March of 2000, the Board asked psychometrician, Norman Hertz, Ph.D. from the Department of Consumer Affairs, Office of Examination Resources, to perform an audit of the AICPA Uniform CPA Examination.<sup>13</sup> He indicated that although AICPA is completing a practice analysis, full implementation is likely to take years and that the current 1991 practice analysis is considered as outdated by California standards. "The challenge for the AICPA is to provide evidence to support its current examination program until the results from the new practice analysis are implemented."

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<sup>13</sup> "Audit Report of the Uniform Certified Public Accountants Examination," Report Prepared By: Norman R. Hertz, Ph.D., Chief, Office of Examination Resources, California Department of Consumer Affairs, May 2000.

Dr. Hertz also made a number of recommendations and specified a number of questions that should be answered by AICPA regarding the administration of its examination. It is unknown whether AICPA has responded to these recommendations and other comments made by Dr. Hertz in his audit report.

**Preliminary Recommendation #14:** *The Office of Examination Resources (OER) of the DCA should report to the JLSRC by September 1, 2001 on whether the AICPA has addressed the concerns and recommendations of OER regarding the administration of its examination.*

**ISSUE #15:** The Board is proposing to raise its examination passage standards to conform to the UAA. These new standards may be more burdensome for candidates attempting to pass this examination, and delay their ability to become a licensed CPA.

**Question #15 for the Board:** *What is the need or justification for requiring the more difficult standards to pass the Uniform CPA Examination? Is it expected that a certain percentage of candidates who sit for the examination could be effected?*

**Background:** As indicated earlier, all applicants must pass the Uniform CPA Examination, which is drafted, graded, and controlled by the AICPA. All 50 states use this exam, which consists of four parts; each part must be passed. Exam passage rules vary from state to state, and California maintains fairly lenient rules compared to other states that have adopted the UAA's standards. Under the UAA, a first-time applicant must (1) take all four parts of the exam, (2) pass at least two parts, and (3) flunk the other two parts with a score of at least 50% in order to be granted "conditional credit" for passing the two passed parts. If an applicant has received "conditional credit" for part of the test, the applicant does not have to retake that part again; he/she needs only to retake and pass the flunked parts. California's rules are more lenient; to receive conditional credit for passing a section of the exam, an applicant simply needs to pass it. The applicant is not required to sit for all four parts and/or obtain a minimum "flunking score" on flunked parts in order to obtain conditional credit for passed parts.

However, the Board is proposing adoption of the UAA's exam passage standards. As explained, the UAA has a more difficult standard for obtaining "conditional credit" on the Uniform CPA Examination. The Board is proposing to adopt the UAA exam passage standard by regulation after enabling statutory changes are enacted. The Board indicates that the UAA exam passage standard is a critical component of adopting other requirements of the UAA, and that 43 states have adopted the UAA exam passage standard. It should be noted, however, that only 10 states require the UAA exam passage standard for reciprocity.

As far as impact on current candidates, the Board indicated that a majority of them do not meet the new exam passage standard. However, under its "transitional proposal," all candidates who have conditional credit, when the new requirement goes into effect, will be able to complete the exam under the requirement in force when they initially sat for the exam.

**Preliminary Recommendation #15:** *The Board should not change its examination passage standards.*



## **PROFESSIONAL CONDUCT ISSUE**

**ISSUE #16:** The Board recently responded to proposed rule changes of the Securities and Exchange Commission (SEC), as it pertains to “auditor independence” requirements for accounting firms that audit company financial statements .

**Question #16 for the Board:** *Have new rules regarding “auditor independence” been adopted by the SEC? If these rules are adopted, will there be any applicability to the profession as a whole that the Board should consider?*

**Background:** In November 2000, the SEC took action to adopt new rules regarding auditor independence for audits of publicly-traded entities. The rules will become effective in 2001, after they are published in the Federal Register. The Board provided both written comment and oral testimony to the SEC during its formulation of the recently adopted rules. Because of the importance of independence, the Board’s regulations mandate that licensees “shall be independent in the performance of services in accordance with professional standards.” The Board’s regulations do not provide detailed standards and restrictions, and instead rely to a great extent on the standards established by other bodies, such as the AICPA and the SEC.

While California CPAs perform thousands of audits and other attest/assurance work, most CPAs do not practice in the “Big 5” firms auditing publicly traded companies. Consequently, most licensees may not be directly impacted by the Commission’s rules. However, the SEC’s recent action may have a significant “trickle down” impact on the concept of independence for the entire profession.

Although the Board has no immediate plan to modify its regulations that addresses auditor independence, it indicates that it will monitor and participate in the development of related professional standards and take independent action if determined warranted.

**Preliminary Recommendation #16:** *No recommendation at this time.*

## **CONTINUING COMPETENCY ISSUES**

**ISSUE #17:** During the prior sunset review, the Joint Committee agreed with the Board’s recommendations to improve its Continuing Education Program. Have these recommendations been implemented?

**Question #17 for the Board:** *What improvements has the Board made to its Continuing Education (CE) Program and what other changes are anticipated to improve the program? Why does the Board believe it is necessary to maintain the current requirement of 80 hours of CE every 2 years? How is the Board assuring that CPAs will know what CE course will and will not be acceptable to meet the new CE requirements adopted by the Board?*

**Background:** Licensees who practice public accounting must complete 80 hours of acceptable CE in the 24-months preceding the license expiration date. Licensees who provide attest or compilation services must complete 24 of the 80 hours of accounting and auditing CE for license renewal. There is also a new requirement that will take effect on July 1, 2001, that licensees complete at least

50 percent of the mandated CE in subject areas such as accounting, auditing, taxation, consulting, financial planning, and similar subject focusing on the public accounting skills and knowledge necessary for competent practice

Improvements to the Board's CE Program. Since the Board's last sunset review, it has taken several steps to improve its CE Program including the following:

- Eliminated its Continuing Education Committee to decrease costs and improve program efficiency. The Committee on Professional Conduct, composed entirely of Board members, has assumed responsibility for considering continuing education policy issues and acting as a forum for public comment.
- Sponsored legislation to mandate a minimum level of continuing education in financial statement disclosure and reporting for licensees who issue financial statements. This requirement was enacted in 1996 (AB 1260, Machado, Chapter 639). The Board adopted implementing regulations requiring licensees who provide attest or compilation services to complete 24 hours of accounting and auditing continuing education for license renewal. This requirement became effective on July 1, 1998.
- AB 1260 also mandated that all active licensees complete continuing education in the Accountancy Act, Board of Accountancy Regulations, and rules of professional conduct every six years. The regulation implementing this important consumer protection measure became effective on July 1, 1997. The regulation also specifies procedures for approval of course providers.
- Conducted a two-year research project to identify educational patterns and trends and advocate program improvements. This study was also recommended by the JLSRC and was included in SB 1077 (Greene, Chapter 1137, and Statutes of 1996). Based on the study, the Board adopted a number of recommendations to improve the CE Program.
- A resulting program improvement was adoption of the requirement that licensees complete at least 50 percent of the mandated CE in specified subject areas.
- Also, as a result of this study, improvements were implemented related to compliance monitoring. The Board is continuing its CE verification program in which one percent of licensees are randomly selected for verification annually. This program has been supplemented by a requirement that at renewal, licensees must report the CE courses they have completed. This reporting requirement was initially implemented for data collection purposes; however, it has proved extremely useful in assisting staff in monitoring compliance and licensees to better understand program requirements. Therefore, the Board concluded it would be beneficial to continue this practice permanently.

Regulations implementing these program improvements and clarifying other components of the Board's Continuing Education Program became effective June 8, 2000. It is anticipated that implementation of these changes will improve the quality of the CE Program and enhance its effectiveness in ensuring that licensees maintain and update their professional skills and knowledge.

Need for the Continued 80 Hours of CE Requirement. In its study, the Board reached several conclusions regarding the appropriateness of the overall 80 hour CE requirement.<sup>14</sup> The Board's report stated that the 80 hour requirement is sufficient to provide the requisite degree of consumer protection. This conclusion was based upon the following findings:

- The majority of licensees responding to an opinion survey indicated that the current requirement of 80 hours was about the "right amount."
- Additionally, the course listed an necessary in certain areas of accounting and auditing, taxation, industry practices, management consulting, and information systems subject areas as necessary to maintain their competency averaged 77.9 hours.

It should be noted that the study also pointed out that the cost of the 80 hour CE requirement is substantial. Based upon responses from the an opinion survey, the average cost of CE, in direct and lost opportunity costs, is at least \$5,600 per licensee per two-year renewal cycle. Total cost, for the profession as a whole, is estimated to be more than \$100 million per year.

The Center for Public Interest Law (CPIL) argues that the Board could easily cut their CE requirement in half – to the great savings of CPAs and their clients. They indicated that Board staff stated at a September 1998 meeting, that "the 80 hour requirement could be significantly reduced without negatively impacting consumer protection." At a January 1999 meeting, however, the Board approved its Committee on Professional Conduct recommendation to retain the 80 hour CE requirement, and also require that 50% of CE hours be in specified areas.

Does the Board Adequately Notify its Licensees of What CE Will Meet its New Requirements?

One of the conclusions reached by the Board's CE Study was that its CE Program was fundamentally sound, but that the Board should continue to regularly inform and educate licensees as to the continuing education requirements. The data collected from the Board's compliance monitoring and verification programs, as well as anecdotal comments from the licensee opinion survey, indicated that many licensees are confused or unaware of their professional responsibilities and options regarding continuing education.

With the new 24 hour "accounting and auditing" requirement for those involved in attest services, and the 50% rule to implemented in 2001, the Board will be under a greater obligation to assure that its licensees are aware of what CE courses will meet or not meet these requirements. There is some indication that the Board is already rejecting certain courses, and its licensees are not aware that these courses would be unacceptable to meet the CE requirement.

**Preliminary Recommendation #17:** *No recommendation at this time concerning the 80 hour CE requirement. (Like to have Department's input on this issue.) However, the Board should report to the JLSRC, by its end of March hearing, on what action it will take to assure that its licensees are fully aware of what CE courses will meet its specified requirements.*

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<sup>14</sup> Page 86 of the CE Board Report.

**ISSUE #18:** The Board is proposing to change its Report Quality Monitoring (RQM) Program and to implement a new peer review program for those performing attest accounting services.

**Question #18 for the Board:** *Please explain recent and proposed changes to the RQM Program and how a peer review program will be implemented. How will these two programs enhance consumer protection? Should a peer review program be created even if other changes to the licensing of CPA's that conform to the UAA are not adopted?*

**Background:** This issue has been dropped since it is adequately covered in Issue #10. The Board has also sufficiently responded to this issue.

## **ENFORCEMENT ISSUES**

**ISSUE #19:** During the prior sunset review, the Joint Committee agreed with the Board's recommendation to improve its overall Enforcement Program pursuant to recommendations made as a result of a business process re-engineering study. Have these recommendations been implemented?

**Question #19 for the Board:** *What improvements has the Board made to its Enforcement Program and what other changes are anticipated to improve the program? How have these changes improved performance of the Enforcement Program in responding to consumer complaints?*

**Background:** In 1995, in accordance with recommendations made by the JLSRC, the Board began reengineering key components of its Enforcement Program. The project's objective was to improve performance through redesigning the workflow, technology, and "people" components of the program. As a first step, utilizing a Department of General Services' Master Services Agreement, the Board contracted with a consulting firm to facilitate the identification of critical program improvements and to prepare a report. The resulting recommendations and performance measures were implemented during FY 1995-96 and FY 1996-97.

One benefit of reengineering, was improved complaint intake and evaluation process utilizing standardized criteria based on area of practice, complexity, and potential for consumer harm. Also as a result of reengineering, procedures for the investigative stage have been standardized and streamlined, and primary responsibility for monitoring case progress during the prosecutorial stage has been redirected from support staff to investigative staff. This modification has reduced costs and time in investigation and prosecution.

In addition to these procedural changes, the Board modified the ratio of investigative to support staff. While the number of professional investigative CPAs has remained the same, the number of administrative staff has decreased. Further, to enhance efficiency and statewide enforcement coverage, the Board bases an investigative CPA in Southern California.

To complete the reengineering process and support ongoing program improvement, the Board developed and implemented performance measures. Use of performance measures has made it possible to evaluate trends, assess the effectiveness of enforcement efforts, and make timely adjustments where required. These changes have resulted in significantly improved performance:

- The Board eliminated the backlog of cases pending for three or four years. More than 70 percent of the cases in the December 1999 case inventory were open less than six months.
- The number of pending investigations of complaints against licensees decreased significantly from 387 in December 1995 to 102 in December 1999.
- The average number of days to process complaints has decreased by 80 percent, from 61 days in fiscal year 1996-97 to 12 days in fiscal year 1999-00.

**Preliminary Recommendation #19:** *(For the DCA to consider: Is this an enforcement program that should be audited by the Department? CPIL is very critical of the Board's current enforcement program.)*

**ISSUE #20:** The Board currently utilizes two committees as part of its overall enforcement program, an "Administrative Committee," composed of 13 licensees, to receive and investigate complaints and conduct investigations or hearings, and an "Enforcement Program Oversight Committee (EPOC)," composed of board members, to develop enforcement policies and conduct an internal audit of enforcement program functions. Both of these enforcement-type committees are unique to this Board. The use of Administrative Committee of all licensees has been criticized in the past as an inappropriate delegation of the Board's enforcement authority. It has also been argued that the EPOC may be in violation of the Bagley-Keene Act and the Administrative Procedures Act.

**Question #20 for the Board:** *Please explain the function and operation of the Administrative Committee throughout the enforcement process and why the Board believes it is essential to its overall enforcement program. Does the Administrative Committee review all cases or just those referred by the Board's investigative staff? Is this current policy of the Board and could it change in the future? Please explain the procedures that the EPOC uses to assure they are not in violation of the Bagley-Keene Act or the Administrative Procedures Act, and why the Board believes this committee is essential to its overall enforcement program.*

### **Background:**

Use of the Administrative Committee (AC) by the Board. Section 5020 of the B&P Code authorizes the creation of an Administrative Committee by the Board to receive and investigate complaints and to conduct investigations or hearings, with or without the filing of a complaint, and to obtain information and evidence relating to any matter involving the conduct of licensees or a violation of the Accountancy Act. However, the AC may only act in an "advisory capacity," and shall have no authority to initiate any disciplinary action against a licensee and shall only be authorized to report its findings from any investigation or hearing to the Board or its executive officer. The AC is composed of 13 licensee members appointed by the Board.

The composition and prior authority of the AC was of serious concern to the JLSRC and the DCA during the previous sunset review. The Center for Public Interest Law (CPIL) brought this issue to the attention of the JLSRC and indicated that the AC was making decisions that exceeded its statutory authority – that it was not simply making enforcement *recommendations*, but making enforcement *decisions*. CPIL argued that the Board's use of the AC represented an excessive, possibly unlawful

and unconstitutional delegation of state police power to private parties. To address these concerns, the JLSRC recommended that the AC sunset on July 1, 1998. The Department of Consumer Affairs also recommended that the AC be eliminated.

It was the Board's position that the AC was a valuable resource in the enforcement process, and it should be continued. Legislation enacted at the end of the previous sunset review (SB 1077, Chapter 1137, Statutes of 1996) eliminated the mandate that the Board appoint the AC, but it permitted the AC to continue as an entity of no more than 13 licensee members, and it also clarified the advisory nature of the committee. Under SB 1077, the AC retained the statutory authority to conduct investigative hearings.

The Board has indicated, that in keeping with these legislative changes, the AC has discontinued the "mandatory" review of enforcement cases. This "policy" change was announced at the Board's July 2000 meeting. The AC continues serving as a technical advisor to the executive officer and enforcement staff, and AC members participate in investigative hearings. Their technical input into these investigative hearings is invaluable to the CPA investigative staff as it assists in clarifying the facts and issues in complex cases.

While the AC occasionally considers policy issues at the request of the Board, ongoing responsibility for the development of Enforcement Program policy recommendations has now been shifted to the Enforcement Program Oversight Committee (EPOC), composed entirely of Board members. (See discussion of EPOC below.)

During the current review process, the Board deliberated the AC's duties and functions at meetings of its Sunset Review Committee in March 1999 and March 2000. The committee considered a report comparing the Board of Accountancy's enforcement procedures with procedures used by the Medical Board. The committee also heard comments from CPIL regarding their objections to the existence of the AC. In addition to the issue of unlawful delegation that was raised at the last sunset review, CPIL also noted there may now be a perceived conflict of interest because of the Board's use of the AC.<sup>15</sup>

After deliberating the matter, the Board concluded at its June 2000 meeting that the AC, as it is currently functioning, would best meet the needs of the Enforcement Program.

The primary reasons for Board's recommendation are:

- AC members have current in-depth expertise in a variety of practice areas such as taxation and auditing. Staff can easily contact these subject matter experts when advice related to specialized technical areas or specialized industries is needed, without the time and expense of hiring consultants.
- The value of the AC is enhanced by the fact that members have familiarity and experience with the Enforcement Program's procedures and priorities.

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<sup>15</sup> CPIL was still concerned that the intimate participation of licensees in Board disciplinary investigations will possibly subject the Board to lawsuits. CPIL cited one case in particular, *KPMG Peat Marwick v. Board of Accountancy* where it was argued that the investigation by the Board of KPMG was tainted because particular members sitting on the AC had an actual or apparent conflict of interest with KPMG.

- The AC has policies and procedures in place which effectively control the risk of conflict of interest and require members to recuse themselves at any time when a potential conflict of interest becomes apparent. Committee members also receive special training related to conflict of interest and their responsibilities as AC members.
- The AC is a very cost-effective resource. With the revision of its activities and functions, the estimated annual cost to support the AC is approximately \$88,000. This cost is more than offset by savings created because outside consultants are rarely needed.
- The AC investigative hearing process is extremely valuable in sorting out the facts in complex enforcement cases that involve large volumes of documents and a variety of technical issues.

Use of the Enforcement Program Oversight Committee (EPOC) by the Board. The EPOC is a committee composed of Board members who periodically meet to discuss policy issues related to Board's enforcement program and develop recommendations to the Board. Two members of the EPOC will occasionally review closed case files to evaluate and monitor compliance with the Board policies. Summary information is subsequently discussed at a noticed open EPOC meeting. Based on legal guidance, the Board believes these reviews pose no significant risk of tainting a Board member should a related disciplinary case come before the Board at a later date. (Board members cannot engage in ex parte communications of disciplinary cases that come before them, this would be a violation of the Administrative Procedures Act, and the Board member would be disqualified from making any decision regarding the case.) The Board indicated that reviews conducted in 1997 and 1998 did not result in a single instance of a Board member being tainted. And that since meetings of the EPOC are open to the public, there is no violation of the Bagley-Keene Act.

CPIL has been critical of the EPOC's process of reviewing closed investigative cases in closed session. It argues that it exposes Board members (who are required to be ultimate decision-makers in Board disciplinary proceedings) to unredacted case files which may be resurrected in future enforcement proceedings.

In 1998 there was a request made by a member of the Board requesting that the Legislature change the Bagley-Keene Open Meeting Act, so that the EPOC would be able to conduct closed sessions, with more than two board members, to discuss and review prior closed disciplinary cases.

The JLSRC responded to a Member's request and indicated the following:

*"The Joint Committee in 1996 recommended for the Board to "take a more proactive role in its enforcement program. This was intended to remind the Board of its ultimate responsibility to assure that its executive officer, staff and CPA investigators have primary oversight and final decision-making regarding referral of cases to the Attorney General, and that it not be delegated to private practitioners or board members."*

*Because of the ability of all licensing boards to review final decisions of the administrative law judge regarding a licensee of the board, it has always been required that individual board members maintain their independence from the day-to-day operations of their enforcement programs in the handling of complaints, investigations and referrals to the Attorney General's Office for prosecution. There was never any intent on the part of the Joint Committee that board members begin "auditing" individual cases, even if closed cases, to assure the proper functioning of its enforcement program.*

*There is always the possibility that a case could be re-opened, or a subsequent complaint filed against someone whose case was previously closed. This would prejudice the board member who was involved in the “auditing” of closed cases. The recent adoption of “The New Administrative Procedures Act” emphasizes the need to keep those “who may preside over subsequent proceedings” separate from those facts which may grant them “specialized knowledge” of a particular case and thereby prejudice or bias their decision.*

*Another concern, is that board members who do not have the expertise or experience in the handling of complaints and investigations would be second guessing decisions made by the executive officer and investigative staff. The experience of the Joint Committee and the Senate Business and Professions Committee, involved in the sunset review and evaluation of all licensing boards over the past four years, has found that the more independence granted to staff in the day-to-day handling of disciplinary cases, the more efficient and effective the enforcement program of the particular board.*

*Since allowing specified board members to go into a closed session and review closed cases would be a substantial change in the overall powers normally granted to boards, and for all the reasons mentioned, we would recommend that this issue be brought up in the context of sunset review for all members of the Joint Committee to consider next year, when the Board of Accountancy is reviewed.*

*There may also be other alternatives the Joint Committee and Board could consider to assure that cases are being handled properly by staff, without having to perform an internal audit of closed enforcement cases. For example, under Section 11126 (c) (2) of the Government Code, an advisory body of the board has the power to make an inquiry into the board’s enforcement program concerning an individual licensee or applicant, where the inquiry occurs prior to the filing of a civil, criminal or administrative disciplinary action against the licensee. This inquiry can be made during a closed session if it is determined that disclosure of such information in an open meeting would be an unwarranted invasion of the privacy of the individual licensee. The scope of this provision would seem to allow the board enough flexibility to review cases as needed, and assure that its enforcement program is operating efficiently and whether it may need improvements”.*

**Preliminary Recommendation #20:** *Section 5020 of the Business and Professions Code should be amended to reflect current policy of the Board to utilize the Administrative Committee to review complaints on a discretionary basis as determined by professional investigative staff. The JLSRC still has concerns about the use of committee composed of Board members to review closed disciplinary cases. If there is sufficient evidence that this practice needs to continue, then such review should be conducted in an open session of the Board. (If the Department assumes more of a role in the oversight and possible audit of the board’s enforcement programs, is this really necessary?)*

**ISSUE #21:** *In fiscal year 1999-00, the Board commenced the prosecution of a single matter involving a large international firm. Litigation expenses related to prosecution of this case have been extremely costly and forced the Board to seek a deficiency request to augment its spending authority.*

**Question #21 for the Board:** *Should the Board be able to access a contingency fund for enforcement cases that may have a significant impact on its overall budgeting for prosecution and hearings costs, rather than having to seek spending authority through the complex deficiency request process? What are the total costs to date for this major case what was the amount of the deficiency request?*



**Background:** This issue has been dropped. It will be covered as a “crosscutting issue” by the JLSRC at its meeting in March, since it is a problem that pertains to other boards as well.

## **BOARD, CONSUMER AND LICENSEE USE OF THE INTERNET ISSUES**

**ISSUE #22:** Is the Board utilizing Internet capabilities to improve services and provide better information to consumers and licensees?

**Question #22 for the Board:** *What has the Board done to enhance its internet capabilities? What other improvements does the Board expect to make?*

**Background:** This year, the DCA recommended that the sunset process require all boards to assess the impact of the Internet on their internal operations and programs, on their licensees, and on consumers. Specifically, DCA recommended that all boards should identify opportunities for streamlining administrative functions and be prepared to address regulation of Internet businesses. As explained by DCA, emerging technologies and business and consumer use of the Internet will have an impact on all Department boards. While offering administrative options, the Internet and electronic commerce also present regulatory and public protection challenges. Boards need to examine the feasibility and appropriateness of offering online license application and testing services and information to consumers, as well as assess their profession’s use of the Internet for conducting business. The trend towards “practice without presence” necessitates a review of practices that now increasingly occur outside California’s traditional “marketplaces.” Special attention must be paid to online advice programs, and to consumer issues such as privacy and targeted marketing. The Department’s boards should provide the leadership necessary to begin setting policies governing their licensees’ use of the Internet.

In July 2000, the DCA asked the Board to complete the Department’s *Assessment of Internet Implications and Options — Survey*. This survey asked the Board to provide the Department with an assessment of their plans to address Internet Implications for regulatory programs. A copy of the Board’s responses to the DCA survey was provided along with its sunset review report.

The Board indicated that it is making the following uses of the internet:

- The Board maintains a comprehensive Web site ([www.dca.ca.gov/cba](http://www.dca.ca.gov/cba)) which is updated daily. In May 2000, the Board made a license look-up feature available on its Web site.
- The Board’s quarterly publication, *UPDATE*, is posted on the Web site, and it contains all disciplinary actions since 1998.
- The Web site also offers two complaint forms, one to file a complaint against a licensee, and the other to register comments/complaints about the California Board of Accountancy. Instructions regarding how to file these complaint forms are included. In addition, the Web site features a comprehensive listing of e-mail addresses and key telephone numbers to aid communication with Board staff. To facilitate electronic communication, all e-mail inquiries are answered within five working days.

- The Board's Web site has had a dramatic increase in use in 1999, as contrasted with 1998. In 1999, from January 1 through December 31, the Web site received 233,866 "hits," contrasted with 78,517 "hits" in 1998. In addition, during 1999 the Board received and responded to 5,620 e-mail requests (inclusive of inquiries from licensees, examinees, and the consumer public).
- During 2000, the Board plans to increase interactive features available via the Web site to assist all visitors in electronically submitting and receiving forms and information.

**Preliminary Recommendation #22:** *No recommendation at this time. (Department may want to respond to this issue.)*

**ISSUE #23:** *Accountants in other states are using the Internet to solicit and possibly provide accounting services to California consumers. The Board's jurisdiction to regulate non-California CPA's and PA's is limited, and the only other alternative is criminal prosecution.*

**Question #23 for the Board:** *How can the Board more effectively regulate accounting services offered by non-California accountants via the Internet to California consumers?*

**Background:** As indicated in the Board's *Assessment of Internet Implications and Options — Survey*, California CPAs and PAs are expanding their offering of public accounting services over the Internet to consumers located inside and outside California. These are areas of practice that are not traditional in the marketplace, in that they allow practice without physical presence. Tax preparation services, via the Internet, is the most common type of service under development at this time.

It is proving to be a challenge for the Board to attempt to regulate non-California CPAs and PAs who serve California consumers without presence in California. California statutes do not provide clear jurisdictional authority for the Board to regulate CPAs and PAs licensed and physically located outside California. Accountants licensed elsewhere, who specifically target their marketing to California consumers, or, who themselves advertise using a California address, could be considered "holding out" and subject to the Board's jurisdiction. A significant problem, however, is that the Board has no California license to discipline and that criminal prosecution through the local District Attorney for unlicensed practice would be difficult at best. The Board is working with NASBA to develop statutory language to more effectively regulate accounting services offered by non-California accountants via the Internet to California consumers.

Colorado's recent changes to its laws may be instructive on this issue. The Attorney General of that State called on its Board of Accountancy to revise its statutes and rules so that its jurisdictional authority over those providing accounting services by electronic or other means is clear.<sup>16</sup>

**Preliminary Recommendation #23:** *No recommendation at this time. (Adopt some of the statutory changes made in Colorado?)*

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<sup>16</sup> Page 46, "Colorado State Board of Accountancy 1999 Sunset Review."

## **CONTINUE OR ELIMINATE BOARD OF ACCOUNTANCY ISSUE**

**ISSUE #24:** Should the Board of Accountancy be continued as a separate agency, or should its responsibilities be transferred to the Department of Consumer Affairs ?

**Background:** (To be completed at a later time.)

**Preliminary Recommendation #24:** *Continue with the Board but extend sunset date for only four years.*